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Interim report to shareholders

For the six months ended March 31, 1978

Ashland Oil Canada Limited

Consolidated statement of income*
(in thousands)

	Three Months Ended March 31 1978	Three Months Ended March 31 1977	Six Months Ended March 31 1978	Six Months Ended March 31 1977
INCOME				
Net sales and operating revenue	$37,047	$29,594	$104,192	$83,627
Gain on disposal of assets	92	31	174	123
Miscellaneous income	346	357	617	692
TOTAL INCOME	37,485	29,982	104,983	84,442
EXPENSES				
Costs and expenses	19,251	17,283	66,048	57,300
Depreciation, depletion and amortization	4,433	4,246	10,365	9,333
Interest on long-term debt	1,055	1,051	2,106	1,871
TOTAL EXPENSES	24,739	22,580	78,519	68,504
Income before minority interest and taxes	12,746	7,402	26,464	15,938
Provision for taxes on income:				
Current	3,890	2,297	10,042	6,311
Deferred	1,748	1,624	1,958	1,762
TOTAL TAXES	5,638	3,921	12,000	8,073
Income before minority interest	7,108	3,481	14,464	7,865
Minority interest	176	176	352	352
NET INCOME	**$ 6,932**	**$ 3,305**	**$ 14,112**	**$ 7,513**
Income per common share:				
Basic income	**53¢**	**26¢**	**$ 1.08**	**58¢**
Fully diluted income	**50¢**	**24¢**	**$ 1.00**	**54¢**
Cash flow from operations†			$ 26,435	$18,608
Average daily production (gross before royalties):				
Crude oil and natural gas liquid products (barrels)			24,850	21,513
Natural gas (millions of cubic feet)			70.0	62.5

On behalf of the Board:

Director

Director

†see accompanying statement of changes in financial position.

Consolidated statement of changes in financial position*

(in thousands)

	Six Months Ended March 31 1978	1977
WORKING CAPITAL WAS PROVIDED FROM:		
Net income	$ 14,112	$ 7,513
Depreciation, depletion and amortization	10,365	9,333
Deferred income taxes	1,958	1,762
Provided from operations	26,435	18,608
Property and equipment disposals	305	164
Proceeds from issue of common shares	493	—
Proceeds from issue of $10^3/_8$% Sinking Fund Debentures	—	30,000
Miscellaneous	169	—
TOTAL WORKING CAPITAL PROVIDED	$ 27,402	$ 48,772
WORKING CAPITAL WAS USED FOR:		
Property and equipment additions	$ 23,032	$ 30,380
Reduction in long-term debt	—	10,031
Debt discount and expenses of issue	—	839
Dividends — preferred shares	41	46
— common shares	1,968	1,292
Miscellaneous	964	945
TOTAL WORKING CAPITAL USED	$ 26,005	$ 43,533
Increase in working capital	$ 1,397	$ 5,239
Working capital at beginning of period	30,755	19,864
Working capital at end of period	$ 32,152	$ 25,103

Condensed consolidated balance sheet*

(in thousands)

	March 31 1978	1977
ASSETS		
Current assets	$ 93,161	$ 77,857
Investments and other assets	5,779	6,003
Property, plant and equipment — net	208,779	186,262
	$307,719	$270,122
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities	$ 61,009	$ 52,754
Deferred production income	577	—
Long-term debt — less current portion	49,907	50,360
Deferred income tax	51,912	48,804
Minority interest	7,032	7,032
Shareholders' equity	137,282	111,172
	$307,719	$270,122

*The above statements are unaudited and subject to year-end adjustments.

To the shareholders:

The Company's net income for the fiscal half year ended March 31st was $14.1 million, or $1.08 per share, compared with $7.5 million or 58¢ per share for the same period last year. Revenue of $105.0 million was up from $84.4 million, while cash flow increased by 42% to $26.4 million.

Capital expenditures for the half year amounted to $23 million which includes $20 million invested in oil and gas exploration and development projects.

As in prior periods, the substantial increase in earnings for the first six months of the fiscal year was primarily due to increases in crude oil and natural gas production and prices.

During the period, crude oil production averaged 24,800 barrels per day, up from 21,500 barrels per day produced in the same period last year. Natural gas production rose 12% from 62.5 million cubic feet per day to an average of 70.0 million cubic feet per day despite the current excess supply situation in Alberta.

The excess gas supply situation has given rise to a considerable amount of conjecture in the industry as to its effect on existing gas sales contracts, marketability of new gas reserves, and the possibility of an increase in volumes which may be exported from Canada. The Company is confident that the continuing exploration for natural gas and resultant build-up of reserves will encourage a resolution of the marketing problem.

Ashland Canada has participated directly in drilling 112 wells, 97 of which have been completed for potential oil or gas production. In addition, 21 wells have been drilled, at no cost to Ashland Canada (under farmout arrangements), resulting in five oil wells and nine gas wells in which the Company retains varying interests.

In the West Pembina area of Alberta, an exploratory well drilled by another company under a farmout agreement at the 2-22-51-7 W5 location was abandoned in the Nisku reef objective but did have minor gas shows uphole which have some potential. The Company has been evaluating by detailed seismic most of its existing West Pembina properties while continuing to acquire further prospective Nisku reef acreage in this area.

In the Elmworth gas trend, Ashland Canada and partners have been successful in acquiring two significant parcels of petroleum and natural gas rights, each comprising 17,600 acres. The Company's interests in the two parcels are 15% and $26\frac{2}{3}$%, respectively. These drilling reservations are located in the province of British Columbia adjacent to the Alberta border. The immediate area is under active exploration by other companies. The Ashland Canada group expects drilling on its properties to be commenced later this year.

Development drilling on the Limestone Mountain deep Mississippian gas structure is continuing. The 7-7-34-10 W5 well has been cased as a potential gas well in the Turner Valley formation and is waiting on final testing and completion. A start on the next well at the 6-24-34-11 W5 location is expected in May.

The outlook for the Company's Asphalt Paving & Materials Division operations is good. A satisfactory backlog of contract work ensures a good start to the forthcoming season and the damage to road surfaces caused by the long, hard winter experienced in many parts of Canada is expected to have a positive influence on the Division's road and highway repair and maintenance activities.

The operation of the Chemical Division continues to make progress with sales and earnings showing considerable improvement over the first six months of fiscal 1977. In March, the Division held an official opening of new warehouse and distribution facilities in Montreal. We expect these new facilities will enhance the Division's chemical distribution capabilities in a strategic market area of Canada.

"Valvoline" sales volumes continue to increase. However, the profit margins remain under considerable pressure primarily as a result of increased product costs. The deterioration in the Canadian foreign exchange rate is a direct factor in that it has caused a rapid escalation in costs of imported raw materials required for the Division products.

Despite a persistent weakness in the Canadian economy, we expect the improved financial results to continue for the balance of the fiscal year.

VERNON VAN SANT, JR.
President and
Chief Executive Officer

May 8, 1978